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TAGS: EFIN ECON ETRD PREL AR
SUBJECT: MID-YEAR STATUS REPORT ON BILAT ECONOMIC ISSUES:
PARIS CLUB, HOLDOUTS, EXIM TOLLING AGREEMENT, ADVOCACY CASES

REF: A. BUENOS AIRES 991
¶B. BUENOS AIRES 976
¶C. LANDBERG/STILWELL 07/17/08 EMAIL
¶D. BUENOS AIRES 984

Classified By: Ambassador E.A. Wayne for Reasons 1.4 (b,d)

Summary

¶1. (C) This cable provides status of bilateral economic issues: Paris Club, holdouts, ExImBank tolling agreement, Post advocacy and ICSID cases, as well as updates on GoA/IMF relations and GoA finances. New Economy Mnister Carlos Fernandez supported his predecessor's Paris Club proposal to make debt payments going forward and reschedule all arrears, but President Cristina Fernandez de Kirchner (CFK) rejected that plan in favor of restructuring all PC debt, including principal outstanding. The Economy Ministry is preparing a draft Presidential decree to sign ExImBank's tolling agreement. Ministry officials consider counterproductive some U.S. holdout bondholders' aggressive actions to force the GoA to compensate them, but are also meeting with other holdout groups pursuing a low-key approach to reach a deal, including new financing for Argentina. The Ministry appears to be making some progress in resolving two advocacy cases (Bowne and TIG Insurance), but continues to insist that U.S. companies must "execute" ICSID arbitral awards through Argentine courts. Post continues to work separately to resolve a case involving UNISYS. The GoA wants to avoid criticism of the manipulation of inflation statistics in IMF Article IV Consultations, making it unlikely these will take place in 2008. A close Ministry source states that President CFK overruled her cabinet in choosing to oppose the IMF reform in May. Ministry officials emphasize that the GoA will easily meet 2008 financing needs and downplay market concerns over the GoA's ability to make debt payments during the period 2009-2011. Given lack of access to international markets and increasing financing costs, however, Argentina will find it difficult to pay Paris Club arrears and settle with holdouts during this period. End Summary.

Finance Secretariat Views on Key Bilat Issues

¶2. (C) This cable summarizes conversations over the last month with new GoA Finance Secretary Hernan Lorenzino and Finance Under Secretary Juan Carlos Barboza at the Ministry of Economy (MECON), providing status updates on Paris Club, holdout bondholders, the proposed tolling agreement with Eximbank, Post advocacy for U.S. companies, and ICSID cases, as well as on GoA relations with the IMF and GoA finances. Secretary Lorenzino, promoted in early May from his position as Financial Attache in Washington, has stated to EconOffs

that the new team at MECON wants to address issues that undermine Argentina's image: mainly Paris Club, holdouts, and INDEC. However, he is realistic in appraising his chances, recognizing that little progress is possible on these issues while the President and GoA are focused on the dispute with farmers over export taxes, and its aftermath (see Ref A for latest). He also tacitly acknowledges new Economy Minister Carlos Fernandez's limited ability to influence the Kirchners.

¶3. (C) For the time being, Lorenzino will serve simultaneously as Finance Secretary and as Financial Attache in Washington, D.C. As such, he has the lead on non-trade related bilateral economic issues with the USG. (Lorenzino informed both Post and U.S. Treasury officials that he will be the point person for most international issues within MECON, since EconMin Carlos Fernandez is more focused on handling domestic issues.) U/S Barboza, Post's most reliable contact in MECON, resigned as of July 18 to take a position in the Argentine Central Bank leading the department that manages official reserves. His departure is a major loss to a Ministry that has already lost much of its top financial talent.

Paris Club: Pick Up Where Previous Minister Left Off
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¶4. (C) Lorenzino has informed EconOffs multiple times that Minister Fernandez decided not to start from scratch, and instead supported the Paris Club negotiating proposal developed in April by former Economy Minister Martin Lousteau and Finance Secretariat staff. However, Finance UnderSecretary Juan Carlos Barboza (PROTECT) explained to

EconOffs during the July 10 Embassy reception for visiting A/S Tom Shannon and Treasury DAS Brian O'Neill that President Cristina Fernandez de Kirchner (CFK) recently rejected the Lousteau proposal.

¶5. (C) Barboza confirms details reported in the press about Lousteau's proposal: 1) it calls for restructuring all arrears, with three years grace and payment over five years (eight years total); 2) it envisions immediately resuming payments on the roughly $1 billion principal still outstanding; 3) the GoA will not accept an IMF role of any kind. Barboza admits that FinSec staff developed the proposal in full knowledge that the Paris Club members were sure to reject it as insufficient. Nevertheless, Barboza and others saw it as a starting point for negotiations. However, according to Barboza, CFK rejected it because it provided insufficient debt relief, and she instructed that the proposal call for restructuring of all PC debt, including all principal outstanding, rather than only arrears. Barboza is aware that the Finance team is preparing another option that has the GoA resuming payments on debt coming due as of January 2009 and restructuring arrears accumulated through ¶2008. (As of April 2008, the GoA's total debt stock, including late interest, to 17 PC creditors equaled $7.92 billion, of which $5.36 arrears, $1.35 outstanding principal, and $1.21 late interest.)

¶6. (C) Lorenzino told Econoff during the July 10 Shannon reception that MECON has given CFK various options to consider, but that the Kirchners were still entirely focused on the farm strike. He commented that he did not see much chance of advancement in internal GoA discussions on Paris Club (or any other financial sector issue) until the Agricultural crisis was resolved. He reiterated earlier comments to Econoffs that he and the Minister appreciate the frank and open dialogue they have with Treasury officials, but for now prefer to keep PC discussions very low key. (Lorenzino informed Econoff prior to the Shannon/O'Neill visit that MECON preferred not to include Paris Club on the agenda of the July 10-11 bilateral consultations, nor were they eager to discuss it during the Minister's planned July 11 bilateral with A/S Shannon, DAS O'Neill, and Ambassador

Wayne. Indeed, it did not come up -- see Ref B for readout.)

¶7. (C) Lorenzino has said in the past that MECON's strategy is to develop informal contacts with the Treasuries of the main PC members, so that when the GoA does present a proposal to the PC Secretariat there will already be an informal consensus built with the major players. (This, however, goes against what prior Finance Secretary Hugo Secondini promised Paris Club Chairman Musca during the spring IMF/World Ban meetings. Secondini reportedly promised that the GoA would only negotiate with the Secretariat.) Lorenzino says he will be in charge of all PC-related discussions with the U.S. and Japan. However, Lorenzino informed both Post and Treasury in June that current Argentine Ambassador to Germany, Guillermo Nielson, who as Finance Secretary in 2005 managed Argentina's sovereign debt exchange, will handle daily talks with EU members of the Paris Club. (According to Barboza, Nielson has already met with French and German counterparts, but received no support for the GoA's proposal of a three-year grace period.)

EXIM Tolling Agreement Moving Forward, Slowly

¶8. Lorenzino told Econoff June 30 that the Economy Ministry is preparing a draft Presidential decree to authorize the Economy Minister to sign a tolling agreement with the U.S. Export Import Bank. (The purpose of this agreement would be to stop the clock on the statute of limitations on the GoA's debts to EXIM, to allow time for the GoA to resolve its bilateral debt to EXIM in the context of broader Paris Club negotiations. This would preclude the need for EXIM to consider suing Argentina in U.S. court for payment.) Lorenzino confirmed that he has spoken with Oswaldo Guglielmino, Argentina's Treasury Attorney (Procurador del Tesoro, an independent GoA official with the rank-equivalent of Minister), who fully supports the initiative.

¶9. (C) In subsequent conversations with Lorenzino's legal advisor, Matias Isasa (and also with U/S Barboza), Econoffs learned that FinSec and Guglielmino's staffs are still working to determine whether the Minister has unilateral authority to sign such an agreement, which would be faster

than going through the President's office. There are apparently "other entities" interested in signing similar agreements, so it would be much easier to complete all of them if the Minister were authorized to sign them. (Comment: Despite this effort, Isasa suspects that most plausible option is the Presidential decree. Regardless, this issue is also likely frozen until the dust settles on the recently resolved farm strike.)

Holdouts -- ATFA Antics "Counterproductive"

¶10. (C) Lorenzino and other GoA officials are highly critical of the actions of the American Task Force Argentina (ATFA), the main U.S.-based holdout bondholder lobbying group (representing bondholders that did not participate in the 2005 debt exchange). ATFA is publicly critical of the Kirchner government's treatment of bondholders in the 2005 exchange (in which the GoA achieved an acceptance rate of only 76% of bondholders in exchange for $82 billion in defaulted bonds; the participants accepted a take-it-or-leave-it offer of about 34 cents per dollar of debt, not covering an additional $18 billion of accrued interest between the 2001 default and 2005 exchange). Lorenzino called ATFA's high-profile publicity campaign in the U.S. and with the U.S. Congress, as well as its occasional satirical cartoons about the Kirchners, "highly counterproductive," as the Kirchners have earned a reputation of responding aggressively to counter critics.

¶11. (C) Lorenzino cautiously acknowledged to Econoff that he has met with representatives of U.S. hedge fund Gramercy, which is pursuing a low-key approach to convince the GoA to

strike a deal with holdout bondholders that would include new financing for Argentina. Gramercy representatives informed Econoff May 31 that the fund is working with Barclays and JPMorgan (as the underwriters) to put together an offer covering the majority of untendered debt. The offer would attempt to replicate the 2005 arrangement, with the additional sweetener of bringing in new financing of around $2.5 billion. Since the GoA would be swapping untendered debt for new instruments there would be no immediate fiscal impact and the GoA could downplay the reopening of the exchange and sell it as a way of bringing in new financing. According to Gramercy, GoA interlocutors have stated their preference that the new financing come in the form of credits for energy sector projects in Patagonia. (Comment: Gramercy is pursuing the opposite tactic of ATFA by maintaining quiet talks and selling the offer as helpful to the GoA. However, given the Kirchners purported aversion to reopening the debt exchange, Post considers it unlikely that this low key method will end with greater success. Also, the GoA's narrow focus on recovering domestic popularity and the political initiative following the bruising and economically damaging farm crisis appears to preclude any GoA action on this for some time.)

¶12. (C) Also in late May, ATFA reps told Econoff of rumors that the GoA has considered pursuing a special deal with German and Italian holdouts, since the German and Italian governments have been so vocal in condemning Argentina's failure to resolve the situation. The ATFA rep further noted that GoA officials appear to believe that they do not have to worry about the U.S., since the USG has not pushed hard on the holdout issue. (Comment: the Embassy has raised this issue in most relevant bilateral meetings over the last two years.) The ATFA rep claimed that German Chancellor Merkel has taken a particularly hard line on the holdout issue with the GoA. (Note: AmEmb Berlin followed up on this comment (Ref C), meeting June 19 with Joachim Steffens, Head of Division for International Investments and Finance and Debt Rescheduling at Germany's Economic Ministry. Steffens stated that Germany -- Argentina's largest creditor -- had taken a principled line on the bond issue. He said that Germany's position is that if Argentina is prepared for a settlement with the Paris Club, then they also have to reach a settlement with bond holders.)

Advocacy cases: Nearing Closure on Bowne, TIG
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¶13. (C) Relatively good news is that the Finance Secretariat has made some progress over the last year in pushing forward compensation proposals for U.S. companies Bowne of New Jersey and TIG Insurance. MECON has prepared a special decree for the President to authorize payment of the $1.4 million owed

to Bowne for publicity work it provided during the 2005 debt exchange. (Bowne printed the prospectus for the exchange, but costs quadrupled when the Italian government demanded a separate, translated prospectus for each of the many thousands of Italian bondholders.) U/S Barboza also has informed Econoffs that MECON also included payment to TIG in the 2008 budget, although Econoffs have not been able to confirm this with the Ministry's Secretariat of Hacienda (Treasury), which controls the budget. (TIG has offered a settlement of close to $10 million of a dispute pending since the early 1990s.) Post continues to work with the Finance Secretariat to determine the timeline for the resolution of both longstanding disputes.

CMS Energy and ICSID cases

¶14. (C) Lorenzino told Econoff June 10 that Bank of America had called him offering to sell the GoA the claim it had just purchased from CMS Energy. He said he declined to discuss a deal because the "appropriate" means to handle the issue was for the claimholder (originally CMS and now BoA) to "execute" the ICSID arbitral panel ruling through Argentine courts.

Lorenzino acknowledged USG disagreement with GoA insistence on using local courts for this purpose, but claimed that there was lengthy Argentine jurisprudence backing this position. Lorenzino termed it a formality, arguing that the Argentine Supreme Court was the appropriate body to "recognize the validity of the award." He said the Supreme Court would only determine that the award meets the criteria of the bilateral treaty and would not get into the details of the decision. (Note: Post has reported separately via classified email to State WHA, EB and Legal and Treasury on Bank of America's attempt to negotiate a deal with the GoA that would combine a discounted payment on the CMS ICSID award with the transfer of a 23% stake in Argentina's TGN natural gas transmission system.)

¶15. (C) Post also continues to work on a separate claim involving Unisys, totaling approximately $55 million for Unisys' development of information systems for the Argentine judicial branch. Unisys suspended its ICSID claim in August 2005 in favor of pursuing low-key negotiations with the GoA. In April 2007, UNISYS accepted a settlement offer of $8 million. However, not only has the judicial branch (represented by the Council of Magistrates) not paid the award, but in April 2008 it filed a countersuit against Unisys for a similar amount. Post has followed up with both the Ministry of Justice and the Council of Magistrates, urging resolution of the case, particularly given that Unisys has been especially accommodating in foregoing the ICSID route in favor of direct negotiations.

IMF Article IV Assessment Delayed to 4th Qtr

¶16. (C) During a June 12 meeting with Treasury DAS Brian O'Neill in Washington, Lorenzino stated that he had discussed with the IMF the possibility of conducting Article IV consultations in the fourth quarter of 2008. In subsequent discussions with Econoff, Lorenzino highlighted the sensitivity of this issue in Argentina and emphasized the difficulty of moving forward with Article IV as long as questions remain over the credibility of INDEC's CPI reports. (national statistics agency INDEC is widely considered to have been manipulating inflation numbers since February 2007, with the official annual inflation rate currently in the 8-9% range, while private estimates place it around 25%.)

¶17. (C) Lorenzino states that the GoA does not want the Article IV to be a judgment on INDEC, which would cause embarrassment for the GoA. He notes that the GoA is implementing a new inflation measurement methodology, and MECON wants to test it over several months before inviting the Fund to begin the review. He acknowledged that the IMF has formally requested information on the new methodology. (Comment: so far, the new methodology does not appear to have resolved INDEC's credibility issue. As long as this situation persists, Post believes it will be difficult for the GoA and IMF to agree to begin the process. Since reestablishing the credibility of INDEC is not politically feasible as long the gap between "official" and true inflation remains in the 10-20% range, Post believes it ambitious to expect the Article IV to take place this year.)

Vote on IMF reform -- "Incredible Stupidity"

¶18. (C) In a rare moment of indiscretion, U/S Barboza (PROTECT) told Econoff that the GoA's decision in early May to be one of only three IMF member countries to vote against the IMF's quota and voice reform was an example of "incredible stupidity." He commented that MECON had sent a proposal to the President recommending approval of the reform, and he understood that the Argentine Central Bank had made a similar recommendation. However, the President had overruled these recommendations. Barboza complained that the action only succeeded in reducing further Argentina's already limited credibility with the IMF and other IMF members.

(Comment: Central Bank President Martin Redrado told Treasury DAS Brian O'Neill July 11 that this vote followed shortly after former Economy Minister Lousteau abruptly resigned -- on April 24 -- and during the transition to new Minister Fernandez. He termed it the equivalent of a bureaucratic snafu. See Ref D for readout of Redrado/O'Neill meeting.) (Additional Comment: Barboza, a true professional and the institutional memory in the Finance Secretariat, had clearly become increasingly frustrated at MECON, partly explaining his move to the Central Bank.)

Financing Program and Mini-Debt Swap

¶19. (C) Lorenzino and Barboza have clarified to Econoffs on various occasions over the last month that MECON does not expect problems in meeting its financing needs in 2008. Lorenzino stated this publicly in a July 2 speech, arguing that the GoA can auto-finance itself (via direct placements to public agencies) without tapping either international or domestic markets. However, FinSec officials acknowledge that financing needs increase sharply for years 2009-2011, to the range of $10-11 billion per year, which will challenge the GoA's capacity to meet its debt obligations. Nevertheless, Lorenzino dismisses concerns in the market that the GoA risks another default in coming years. (Most local economists expect the GoA to be able to meet its financing needs during 2009-2011 through issuing debt to public agencies, local banks and pension funds, and sales to Venezuela; however, they acknowledge downside risks of a deteriorating fiscal balance if growth slows more rapidly than expected, or the GoA increases spending above current levels, or international commodity prices fall sharply.)

¶20. (C) Lorenzino notes that MECON still considers refinancing debt coming due during 2009 - 2011 as a viable option, despite U.S. holdout bondholders' attempts to block such a debt swap in New York Courts. (Holdouts have filed a lawsuit in the U.S. District Court for the Southern District of New York in an attempt to attach GoA Global bonds that back the Argentine Guaranteed Loans that would comprise the majority portion of a mini-debt exchange. Most observers believe the lawsuit has effectively frozen the GoA's plan to conduct a swap of the guaranteed loans to smooth out the 2009-2011 debt amortization schedule.) Lorenzino argues that the lawsuit is not the main impediment; rather the current market -- with expected yields on GoA issuances currently at 12 - 14% -- makes a debt swap covering up to $33 billion in GoA debt untenable for the moment.

¶21. (C) Comment: Post generally agrees that the GoA will find the means to meet its financing needs during the difficult 2009-2011 period, after which financing levels mostly drop down to more manageable levels. However, given the GoA's current lack of access to international markets, and high costs of raising funds through domestic issuances or via private placements with Venezuela, it will become increasingly unlikely the GoA will be willing and able to access adequate additional funds to begin payments to both Paris Club and Holdout creditors during this period. The only viable alternative may be to use Central Bank reserves, although that route would create numerous legislative and legal complications, including by possibly generating new legal claims by private international debt holders.
WAYNE